



REPLY TO
ATTENTION OF

**DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
FINANCIAL MANAGEMENT AND COMPTROLLER
109 ARMY PENTAGON
WASHINGTON DC 20310-0109**



AUG 28 2001

**MEMORANDUM FOR FUND MANAGER, ARMY BANKING AND INVESTMENT
FUND**

SUBJECT: Investment Policy

The purpose of this memorandum is to outline policy for investment operations. It is a supplement to guidance contained in pertinent regulations, and supersedes SAFM-ZC memorandum, dated 26 March 1996, subject: Investment Policy.

Investment Funds:

a. Army Banking and Investment Fund (ABIF). The ABIF is the Army's primary investment vehicle, holding monetary assets on behalf of NAFIs until such funds are required for authorized program expenditures. Monies are deposited in the central bank by NAFIs, where sufficient funds are retained to meet daily cash requirements. The remainder is invested in such a manner as to provide interest payments comparable with similar short term bond mutual funds. ABIF investment operations will be in compliance with criteria outlined in this memorandum.

b. Army NAF Central Retirement Fund (ACRF) Trust. The NAF Retirement Trust represents funds being invested for the long-term benefit of participating NAF employees. The Trustees of the U.S. Army Nonappropriated Fund Employee Retirement Plan Trust have responsibility for the investment of the Trust Fund. Deposits in the ABIF are an authorized investment for the Trust. The Banking and Investment Office will provide support to the Trustees as outlined in the Memorandum of Agreement between the Commander, CFSC and the Trustees.

c. Army NAF Employee 401(k) Savings Plan Trust. The Army 401(k) Savings Plan Trust represents funds assigned to outside investment managers by employees participating in the 401(k) Savings Plan. Trust funds are also authorized to be deposited in the ABIF. The Banking and Investment Office will provide support to the Trustees as outlined in the Memorandum of Agreement between the Commander, CFSC and the Trustees.

Responsibilities:

a. The Chief Financial Management Officer, as Fund Manager for the ABIF, has fiduciary responsibility for the development of investment objectives, procedures,

strategies, and performance of the investment program. He or she provides direct supervision of the Chief, Banking and Investment Office. He or she will keep the Commander, CFSC informed of any potentially adverse situations in the financial markets that would affect the investment portfolio, and proposed mitigating actions, if any.

b. The Chief, Banking and Investment Office is responsible for the daily operation of the investment program, including supervision of investment officers. Investment Officers are responsible for researching the market place for authorized investment opportunities and executing strategies previously approved by the Chief Financial Management Officer and Office Chief.

c. The Financial Administration Division (FAD) will perform all cash transfer functions. The Chief, Banking and Investment Office is responsible to reconcile monthly the inventory recorded on the ABIF portfolio tracking system to the accounting records maintained by the FAD.

d. The Investment Subcommittee of the Finance Committee of the MWR Board of Directors provides review and advice to the Commander on matters related to investment objectives, procedures, strategy and performance. The Commander, CFSC, is Chairman of the Subcommittee; members include representatives from SAFM and an Army MACOM. The Committee meets quarterly or at the call of the Chairman.

e. The Commander CFSC will immediately notify both the Assistant Secretaries of the Army (FM&C) and (M&RA) of any significant losses, realized or unrealized, of principal; of circumstances where investments produce no yield; or any other situation warranting notification.

NAFIs are not to generate funds for the purpose of investment; therefore, funds are deposited and invested until they can be expended.

Basic tenets of the investment program:

a. **Security.** Preservation of principal is the primary objective of the Fund. To the maximum extent possible a dollar invested shall be worth a dollar to depositors. Depositors will not be required to recognize changes in the value of investments resulting from market conditions. In addition to the limitations imposed on investments by the Department of Defense, the following restrictions will be in force:

(1) No more than 10 percent of the portfolio's market value shall be held in securities with final maturities greater than three years.

(2) No security shall be purchased for the ABIF with a final maturity or final cash flow greater than sixty (60) months.

(3) Mortgage-backed securities shall be measured monthly for security extension and price risk. Securities which exhibit security extension and/or price risk in excess of the level established in the Standard Operating Procedure (SOP) shall be sold, unless overridden by the Chief Financial Management Officer. In the event that the sale requirement is overridden, documentation describing the characteristics of the security and the surrounding interest rate environment shall be prepared and submitted as part of the record of the next Investment Subcommittee meeting.

(4) With the exception of issues of the U.S. Treasury and issues of U.S. Government Agencies larger than \$1 billion, no more than 5 percent of the portfolio's aggregate market value shall be held in one investment issue. The Fund shall be restricted to a no more than 5 percent ownership share of any one issue, regardless of issuer, and to issues with an original issue size of at least \$100.00 million.

(5) The Fund shall be restricted from investing in certain securities, as follows:

a) The Fund shall not purchase any security whose interest rate changes periodically based on a spread within a band of interest rates, any security which might be characterized as an "inverse floater," or any floating rate security with a coupon determined by a complex formula.

b) The Fund shall not purchase any security with maturity over two years with variable interest rates that are preset at the time of issue.

c) No security shall be purchased that has the potential for experiencing a non-accrual interest period prior to the maturity of the issue. An exception may be made by the Chief Financial Management Officer, if the security can be purchased at a discount to provide a competitive return as a zero coupon bond.

d) The Fund may purchase securities with floors. These provide defensive protection in a falling interest rate environment.

(6) The Fund may purchase floating rate securities whose coupons reset based on a simple spread to a readily available index. Those with caps must conform to safety considerations defined in the SOP.

b. **Liquidity.** Funds will be available as required for all depositors. To achieve this objective, the Fund must hold a combination of securities and overnight investments that can be readily accessed. The Fund shall hold a core position of not less than 10 percent of the Fund's par value in overnight investments, in agency securities maturing within one month or in U.S. Treasury securities. Securities which require lengthy and complex analysis in order to effect their sale shall be purchased only upon documentation of their benefit to the Fund, and approval of the Chief Financial Management Officer.

c. **Yield.** Another objective of the Fund will be to provide a competitive rate to the depositors. Yield shall not take precedence over security and liquidity requirements. Any capital gains recognized through the sale of securities shall be considered one form of portfolio return. Given certain market conditions, it may be prudent to incur capital losses. When these occur, they will be highlighted to the subcommittee and reported in writing to the Assistant Secretaries of the Army (FM&C) and (M&RA). The performance of the ABIF will be measured against the performance of comparable industry products identified by the subcommittee.

The ABIF Fund Manager will be appointed in writing. During change of Fund Managers, both new and old fund managers will confirm fund balances through the reconciliation of assets and liabilities. Outside resources to be used for reconciliation include documentation from the central bank and custodian bank statements.

Personnel of the Banking and Investment Office who are authorized to trade securities will be so appointed in writing by the Commander, U.S. Army Community and Family Support Center.

Specialized Activities:

a. The ABIF will perform foreign currency purchasing and hedging operations as requested by the MACOMs, FAD, and other headquarters-level entities to meet known foreign currency obligations of NAFIs of the Army.

b. With the express written approval of Commander, U.S. Army Community and Family Support Center, the ABIF may loan monies to other nonappropriated fund instrumentalities as authorized by regulations and directives. Each circumstance will be decided on its own merits. The Fund Manager will closely monitor the extent and maturity of loan activity so as to not impair liquidity.

Limitations:

a. Repurchase agreements are authorized, not to exceed twenty percent (20 percent) of the ABIF portfolio. Repurchase agreements are authorized only with primary government securities dealers who are certified by, and who meet capital adequacy standards established by the Federal Reserve Bank of New York. Collateral margin for repurchase agreements will be no less than 102 percent of the combined value of the repurchase security and accrued interest. Securities pledged as collateral for repurchase agreements are limited to U.S. Treasury issues only (Bills, Notes, and Bonds), and must mature within three years. Delivery of funds and receipt of securities will be through the ABIF custodian bank only. A Master Repurchase Agreement as prepared by the Public Securities Association will be executed with each primary government securities dealer before repurchase agreements are initiated.

b. During periods of unusually heavy cash withdrawals by depositors, the Fund may from time to time have a temporary need for cash, and may enter into reverse repurchase agreements for this purpose. Reverse repurchase agreements for investment purposes are authorized only under the following conditions:

(1) Securities being sold must generate an interest cost below the rate at which funds are reinvested.

(2) Funds reinvested will match the maturity of the reverse agreement, or funds to close the reverse repo will otherwise be available from the maturity of a short-term portfolio security, including called securities to their announced call date.

(3) No reverse repurchase will exceed a term of sixty (60) days.

(4) Reverse repurchase agreements will not exceed 5 percent of the market value of the portfolio.

c. Firm forward commitments (instruments purchased on a "when-issued" basis) will not be made in excess of five percent of the face value of the investment portfolio, unless anticipated cash flows between purchase date and settlement date exceed five percent of the portfolio's face value, but will not be made for speculative purposes. Forward commitments in excess of five percent will not exceed anticipated cash flows.

d. Securities will neither be bought nor sold on margin.

e. Transactions will be conducted only with primary government securities dealers and reporting government securities dealers as defined by the Federal Reserve Bank of New York, or directly with banks for the purchase of Certificates of Deposit. Exceptions will be made on an individual basis, after documentation of the firm's satisfactory financial condition and the value of the relationship to the fund.

Oversight:

a. The chain of command is responsible for investment of NAF monies at all levels. Both the Finance Committee of the MWR Board of Directors and its Investment Subcommittee review the investment environment, monitor the investment program and will report periodically to the Executive Committee of the MWR Board of Directors.

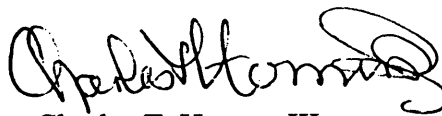
b. Reports prepared to meet DoD oversight requirements will be forwarded from the Commander, CFSC, through the Assistant Secretaries of the Army (M&RA) and (FM&C) to Office of the Secretary of Defense (FM).

c. The Fund will be audited annually by an independent certified public accounting firm or the U.S. Army Audit Agency. Audit findings, to include command comments,

will be presented both to the Investment Subcommittee and the Finance Committee of the MWR Board of Directors.

d. The CFSC Internal Review Office will review the ABIF at least annually, providing follow-up on commercial auditor findings and recommending additional controls necessary to enhance operations.

Procedures for investments operations will be documented in a Standing Operation Procedure (SOP). Both the SOP and this policy memorandum will be reviewed for possible amendment annually. Documentation of these reviews will be presented to the Investment Subcommittee.

A handwritten signature in black ink, appearing to read 'Charles T. Horner, III', with a stylized flourish at the end.

Charles T. Horner, III
Principal Deputy Assistant Secretary of the Army
(Financial Management & Comptroller)